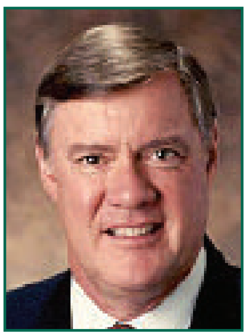
Proximity and Savings—a Case for Offshoring to Mexico



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By Nicholas R. Criss, SIOR

American industry is under unprecedented pressure to reduce costs. The supply chains of virtually every industry in the country have already adopted the Wal-Mart/GE model of continuous product improvement and simultaneous cost reductions. In the beginning, there was a lot of fat to target. Lean Manufacturing, Six Sigma, and Value Engineering initially made significant cost reductions possible, but now the fat is gone and further quantum leaps in cost savings must come from the only remaining source; labor cost. This has driven the current explosion of offshoring of production facilities.

No doubt your manufacturing clients are being forced, by customer demands or by the need to gain an advantage over their competitors, to examine their options for offshore cost reduction. Whatever the reason, discussions about offshoring within the company rarely include the Real Estate Director because these sensitive strategic decisions are not primarily real estate driven.

However, a savvy professional can assist corporate decision makers with these decisions by leveraging the international capability of SIOR, capitalizing on a significant stream of referral business even from companies that are completely stagnant in the local market or in the United States.

To capitalize on your relationships with corporate decision makers, you need to understand what they are looking for. Initially, they do not need help looking for real estate. Their strategic discussions revolve around developing a budget for the set up and operation of a foreign facility. To establish the budget, they generally create a small fact finding group that gets its information from governmental agencies in the countries of interest. However, this information can be self-serving and, at its worst, even fraudulent.

What corporate decision makers need most is unbiased information from sources that have no conflict of interest. Country-specific issues must be uncovered and faced in order to create fiscally responsible budgets that decision makers can justify.

It is important for international real estate firms to maintain a group of experienced operational consulting specialists in each country where they do business. These specialists can answer basic questions about a proposed move to a country before complete real estate requirements have been developed. By offering this service, the real estate company providing relevant information to decision makers helps the parties develop a relationship in the early stages of the project and increases the competitive advantage of the firm. The real estate assignment generally follows naturally from this initial strategy.

To have an in depth conversation with decision makers about their offshoring strategy, you must also understand the typical options companies explore. Presently, the top two locations for U.S. companies are Mexico and China—both have competitive advantages.

Mexico Versus China

It's Not only Cheap Labor

Most companies face a choice between "offshoring" in China or "nearshoring" in Mexico. China has certainly held the spotlight for the last several years where hundreds of companies, lured by cheap labor costs, moved manufacturing operations to China. Mexico, on the other hand, was pushed into the background because its newfound stability and stable currency had made its labor more expensive than China. However, after the initial boom in China, manufacturers now see the relative merits of each for solving specific manufacturing requirements. Companies that do their homework find that the low wages in China mask some serious problems including product quality and safety (as witnessed by the recent recalls of Chinese food products and toys). Oversight of Chinese production facilities is at times lax thus China is still well behind other locations, including Mexico on issues of quality and safety. In addition, China does not protect intellectual property. Other factors to consider are the high logistics costs, both in time and money, which can eat away a great deal of the labor savings. Finally, companies have seen the toll on managers who attempt to manage manufacturing operations half a world away.

Stability Issues

China's stability raises concerns, as well. With increased economic freedom has come increased political repression. Rapid economic growth has displaced hundreds of millions of people and caused severe environmental damage. These pressures cannot be permanently controlled by political repression.

The Logistics Savings

Reevaluation of China has caused a reassessment of Mexico. While Mexico's labor is more expensive than that of China, Mexico has the advantage of proximity to the largest consumer market in the world. Logistical savings can make up for labor costs in a number of products. Moreover, its stability and the security of intellectual property make it a much less risky choice for sensitive operations. Mexico can handle just-in-time and custom production that is impossible in China. Mexico is also much less stressful on management because operations are only one or two time zones away and Mexicans assimilate U.S. technology and methods very quickly. Additionally, a well-trained cadre of managers and engineers know how to work with American companies.

Mexico's economy is now considered investment-grade by the rating agencies. The currency is a model of stability that has allowed a vibrant middle class to emerge. Mexico is now a full-fledged democracy, albeit with some growing pains, and has been a strategic partner with the United States for some time. The level of integration between the U.S. and Mexican economies is such that, regardless of the rhetoric of any administration in either country, they will continue to move forward in economic lockstep.

As the dust settles, a consensus is beginning to emerge. Certain industries that stress low mix/high volume production and that do not have a very high logistics penalty are the proper products for China if quality and safety issues can be addressed and ensured. These sectors include small electronics assembly, apparel, shoes, toys, and low-end furniture, among others. Chinese products could also include commodities; that is, products with no proprietary technology where price is the only relevant factor.

For Mexico, certain sectors are going to remain entrenched, either because they have logistics constraints, intellectual property constraints, or are low volume/high mix custom or just-in-time products. These sectors include automotive, aerospace, medical devices, large electronics, large appliances, engineering, and design centers. Since the OEMs of these sectors are already in Mexico, the very strong trend will be for the vertical integration of the supply chains that support these industries in Mexico including tier 1 and 2 suppliers and distribution centers. In the last two years we have seen supplier parks set up for Ford, Chrysler, Maytag, Whirlpool, Electrolux, and Bombardier. Design centers have opened for Delphi, Visteon, and GE, among others.

Relevant Information Makes the Case

With the information presented, you have what you need to council clients letting them know you understand what their issues are and that you have access to the resources to help solve them. The typical potential prospect is a mid-sized tier one or two supplier. The CEO, CFO, or Director of Manufacturing will control the project. The Director of Real Estate, if they have one, will probably not be in the loop at this point. Remember, this prospect may not be doing anything in your local market but might have many projects underway offshore. They may get 20 calls a day from brokers trying to help them with non existent local requirements but react very positively to the one broker who understands and can help with their real problem. Remember, they are desperate for accurate information. Going offshore can be daunting. You can be the one who has the right information.

The SIOR Connection

These transactions can provide huge rewards. Most projects coming into Mexico are not represented by qualified professionals. These opportunities exist all over the country. Take advantage of them. You joined SIOR to leverage our capabilities….now, get started!